No. 20552

United States Court of Appeals

FOR THE NINTH CIRCUIT

ISLAND AIRLINES, INCORPORATED, *Petitioner,*

v.

CIVIL AERONAUTICS BOARD, *Respondent.*

BRIEF FOR THE PETITIONER

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INDEX

CASES: Page

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I. JURISDICTION

Jurisdiction of this proceeding to review an order of the Civil Aeronautics Board (CAB) rests in this Court under § 1006 of the Federal Aviation Act of 1958 (the Act), 49 U.S.C. 1486—petitioner (Island Airlines) being a Hawaii corporation with its principal place of business in Honolulu.

II. STATEMENT OF THE CASE

The petition requests this Court to review and nullify a CAB order (R. 167-70) denying Island Airlines exemption from economic regulation by the Federal Government under Title IV of the Act, 49 U.S.C. 1371 ff. Island sought the exemption by a petition (R. 1-35) addressed to the CAB under § 416(b) of the Act, 49 U.S.C. 1386(b).[1] The CAB order of denial (R. 167-70) was served October 12, 1965.

Island has been authorized by the State of Hawaii to carry passengers by air solely from points in Hawaii to other points in Hawaii—i.e., to carry intrastate passengers

[1] The cited sections and others deemed pertinent are printed in the appendix.

exclusively. Its current authority is an order of the Hawaii Public Utilities Commission issued February 1, 1965 (R. 9-10). Under a previous order of the same Commission, Island operated during 1963 in Hawaiian *inter*island but *intra*state commerce. It has not, however, operated since 1963 because its operation has been enjoined by the United States District Court for Hawaii. The injunction issued at the suit of the CAB and was affirmed by this Court on October 29, 1965 in *Island Airlines, Inc.* v. *C.A.B.*, 352 F.2d 735.

This decision establishes that (a) the ocean channels between the islands comprising the State of Hawaii are international waters; (b) the United States can assume jurisdiction of flights which traverse such channels enroute solely between places in Hawaii; and (c) the United States *has* assumed such jurisdiction in the Federal Aviation Act.

The exemption petition to the CAB was framed in recognition of these basic principles. The petition asserted, however, a distinction between the *constitutional power* of the Federal Government to regulate intrastate commerce over the high seas, and the *administrative propriety* of such regulation by the CAB under the standards which the Act establishes—including standards for exemption. That distinction was not involved in the previous *Island* case.[2]

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2 The decision said (352 F. 2d at 742):

> "Appellant urges that the federal agencies and the courts should refrain from exercising jurisdiction, in view of the Hawaiian Supreme Court's decision, upholding the Hawaiian Public Utilities Commission's jurisdiction. (Application of Island Airlines, Inc., 47 Haw. 1, 384 P. 2d 536 (1963).) Such position, in our view, begs the fundamental question. If the flights are intrastate, then of course, the federal courts should not permit the C.A.B. to require a certificate, but conversely, if the 'channels' are high seas, then flight over them should and must be subject to the C.A.B.'s authority. This general principle of the supremacy of federal control over interstate and high seas flights must prevail, if the facts support it, over the paramount importance to the Hawaiian economy of inter-island air transportation."

The Court was here treating the CAB as the instrument of federal supremacy. The quoted language had no bearing on the problem of administration forbearance, since the discretion of the CAB to issue exemptions in proper cases had not been invoked.

The previous case was litigated and decided as if the CAB were *required* to act whenever federal power could be sustained. This, however, is not what the Act provides. It looks not in one direction but in two: towards regulation in many instances; towards exemption in some. Thus, while § 401, 49 U.S.C. 1371, provides that no air carrier "shall engage in any air transportation" (as defined) without a CAB certificate, § 416(b) empowers the agency to "exempt from the requirements of this title or any provision thereof . . . any air carrier or class of air carriers" if it finds that enforcement would be an "undue burden . . . by reason of the limited extent of, or unusual circumstances affecting, the operations of such air carrier or class of air carriers and is not in the public interest."

The question whether Island or other carriers of its class should be exempted from regulation has not heretofore come before this Court—nor could it have without prior submission to the CAB. Accordingly, Island filed its CAB exemption petition upon securing rate and operating authority under the State P.U.C. order of February 25, 1965. Island sought exemption not for itself alone but also for "others similarly situated" (R. 2). Its petition was supported by a resolution of the Hawaii Senate (R. 30-32); by a concurrent resolution of both houses of the State's legislature (R. 33-35); and by the Boards of Supervisors of Maui and Kauai counties.[3] The legislative resolutions were attached to and filed with and as a part of Island's petition. The resolutions requested the CAB to establish a special class of "Hawaiian Intrastate Carriers" (comprising those carriers in Hawaii who were federally regulated solely because their flight paths cross channels of the high seas in interisland flights) and to exempt them from Title IV regulation.

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[3] The Maui petition is in the record (pp. 158-59). The Kauai petition is not, but the CAB transmitted a copy to the Court by letter of January 20, 1965, which authorized the Court to refer to it.

The CAB received answers to the Island petition from Hawaiian (R. 38-142) and Aloha (R. 143-157) Airlines. Those answers tendered issues of fact which Island had no opportunity to contest. On October 11, 1965, the CAB, without a hearing and without announcing its procedure, denied the Island petition by the order here under review, which rested in large part on facts asserted by Aloha and Hawaiian airlines in unverified pleadings, but never proved. By identical letters of October 12, 1965,[4] the CAB denied the petitions of the Hawaii legislature solely on the basis of the order which had denied Island's petition.

III. SPECIFICATION OF ERRORS

A. Denial of exemption was arbitrary and capricious, and constituted an abuse of discretion and legal error in view of the purposes and policies of the Federal Aviation Act and the undisputed facts of record.

B. Denial of exemption was unlawful because it extinguished Hawaii's power over its intrastate commerce in derogation of Hawaii's "equal footing" with other states under the U.S. Constitution and the Hawaii Statehood Act.

C. The order under review is (1) unsupported by substantial evidence, and (2) based on evidence received without a hearing or other lawful fact-finding procedure in violation of sections 4 and 5 of the Administrative Procedure Act (5 U.S.C. 1003, 1004) and the due process requirement of Amendment 5 to the U.S. Constitution.

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[4] Available to the Court by virtue of the CAB letter of January 20, 1966, and annexed as Exhibit A to Island's Petition to this Court.

IV. ARGUMENT

A. DENIAL OF ISLAND'S EXEMPTION PETITION WAS ARBITRARY, CAPRICIOUS, AN ABUSE OF DISCRETION, AND LEGALLY WRONG UNDER THE FEDERAL AVIATION ACT.

Agency action which is "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law" is subject to judicial correction under § 10(e) of the Administrative Procedure Act, 5 U.S.C. 1009(e).

The standards for testing abuse of discretion fall short of exactness but in general demand that agency action, to survive review, fall within the bounds of good sense and sound reason. *National Labor Relations Board* v. *Guernsey-Muskingum Electric Co-op, Inc.,* 285 F. 2d 8, 11 (6th Cir., 1960) states:

> "There is no exact measure of what constitutes abuse of discretion. It is more than the substitution of the judgment of one tribunal for that of another. Judicial discretion is governed by the situation and circumstances affecting each individual case. 'Even where an appellate court has power to review the exercise of such discretion, the inquiry is confined to whether such situation and circumstances clearly show an abuse of discretion, that is, arbitrary action not justifiable in view of such situation and circumstances.' Hartford-Empire Co. v. Obear-Nester Glass Co., 8 Cir., 95 F.2d 414, 417."

Except where agency action is held totally non-reviewable because *conclusively* committed to agency discretion[5] the agency is held to "a sound discretion exercised in a

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[5] See Ferry v. Udall, 336 F. 2d 706, 711 (9th Cir., 1964), cert. denied 381 U.S. 904, where this court held that the refusal of the Secretary of the Interior (for any reason or none) to sell public lands, was non-reviewable, as a matter of substantive law. Action of the type in question, denying a governmental benefit, is commonly held to be further beyond the reach of a reviewing court than action which "denies a vested property right or which imposes a substantial obligation or burden." Hamel v. Nelson, 226 F. Supp. 96, 99 (N.D. Calif., 1963), citing Davis, Administrative Law (1958 ed.), § 28.19.

manner that is not violative of due process." *First Nat. Bank of Smithfield* v. *First Nat. Bank of E.N.C.,* 232 F. Supp. 725, 730 (E.D. N.C., 1964). A grant of discretion does not mean "unfettered discretion." *Freeman* v. *Brown,* 342 F. 2d 205, 212-13 (5th Cir., 1965); *Vucinic* v. *U. S. Immigration & Naturalization Service,* 243 F. Supp. 113, 116 (D.C. Ore., 1965). For the CAB in passing on exemption applications, the question has been answered by *American Airlines* v. *Civil Aeronautics Board,* 235 F. 2d 845, 853 (D.C. Cir., 1956) holding that the statute "requires [the Board] to find, not in conclusory fashion in the statutory language but in such fashion that a reviewing court can test the validity of the finding." We contend that the CAB has thwarted the reviewing function as to findings which it should have made but failed to make, and invited reversal of those it did make because they were clearly wrong.

1. The Petition to the CAB

Island's petition to the Board for exemption rested on these major propositions:

a. Hawaii is now a state.

b. Island has been authorized, under a rate order of the Hawaii Public Utilities Commission, to engage in the transportation of passengers solely between places in Hawaii—i.e., in commerce which is in fact and in substance intrastate (R. 1).

c. Island proposes to operate only as so authorized (R. 4, 9-10, 13).

d. The type of operation authorized for and proposed by Island would be subject to state regulation exclusively in every state of the Union other than Hawaii (R. 1-2).

e. Federal jurisdiction of Hawaii's intrastate commerce rests entirely on the geographic happenstance that Hawaii is an island archipelago so that planes in flight from island to island must transit ocean channels

more than six miles wide (R. 1-2). Island, however, will carry no passengers in commerce "with foreign Nations" or "among the several states" or "with the Indian Tribes" (Constitution, Art. 1, § 8).

f. Despite the technically international status of interisland channels, the United States, through the Federal Aviation Administrator, has treated the Hawaiian archipelago for practical purposes as continuous United States territory by designating federal airways between all of the Hawaiian islands. Such designation is permissible only in "air space of the United States" (R. 10-12).

g. Hawaii stands in peculiar need of power to regulate and promote its local air commerce because air travel is the only available means of inter-island passenger travel (R. 25). Its total dependence on air transportation has been recognized by the Supreme Court of Hawaii (R. 8), the CAB (R. 14-16), and the Hawaii legislature (R. 24, 30-35).

h. The CAB has in the past exercised its exemption power in conformity with the principles advocated by Island (R. 23-24).

i. The law encourages deference towards state sovereignty where federal jurisdiction rests on a purely technical basis (R. 20-24).

j. The only possible ground of federal interest in intra-Hawaii air service is the protection of two existing air carriers from competition. Neither of such carriers, however, has ever met the test of public convenience and necessity which the CAB demands that Island pass before engaging in Hawaii's local commerce (R. 13).[6]

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[6] Hawaiian Airlines was certified as a grandfather carrier. Aloha Airlines was certified to provide competition with Hawaiian. Both events occurred when Hawaii was a territory and the federal government was the local governing authority, as is the state government today (R. 13-17).

2. The CAB Order of Denial

The CAB order denying exemption (R. 167-70) summarizes various contentions advanced by Island but neither analyzes nor refutes any of them. While *stating* that "Island has not made a sufficient showing . . . " (R. 168(a)),[7] the CAB *decides* adversely to Island on the exclusive basis of two "facts" alleged in the answers of the presently-certified airlines but never made the subject of a hearing or any substitute procedure in which the facts (or their significance) could be tested.[8] The first of such facts is that the federal government has spent over $6,000,000 of subsidy on the interveners since 1949. The second is that the interveners would lose nearly $5,000,000 in annual revenues to the proposed Island operation.[9] "Under these circumstances," says the order, "it would not be in the public interest to grant exemption authority permitting a carrier or carriers to operate in direct competition with Aloha and Hawaiian." (R. 168(a)).

The order next rejects Island's contention that federal jurisdiction rested on a "technical" foundation (R. 168(b)). Rejection was based solely on a statement in the report of the Senate Insular Affairs Committee on the Hawaiian Statehood Act (R. 53) that the Federal Aviation Act "and other applicable Federal legislation" should continue to apply between places in Hawaii. We discuss these matters in inverse order.

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[7] Two pages are numbered 168. We designate them as 168(a) and 168(b).

[8] The failure of the CAB to afford opportunity for Island to contest or refute the interveners' allegations is the subject of a separate assignment of error. See pages 34-38, below.

[9] The CAB presumably knows and can notice officially the amount of subsidy paid; the precise sum (as distinguished from its legal effect) seems of minor importance, and we do not contest it. The findings on diversion, however, are strongly contested. They rest on nothing but estimates (in a lawyer's unverified pleading) and can in no sense be taken as evidence. Minnesota Rate Cases (Simpson v. Shepard), 230 U.S. 352 (1913). The estimates would have been attacked and rebutted had opportunity been afforded, and the rebuttal evidence would have included current CAB material in direct conflict with its conclusions here.

3. Senate Report on the Statehood Act

The relevant document is Senate Report 80, 86th Congress, 1st Session. The passage cited by the CAB is quoted in part in Hawaiian's answer (R. 53), to the effect above noted. The quoted passage was followed in the report by an approving reference (unmentioned by Hawaiian) to Interior Department memoranda set out in Appendix F to the report. The report invites two comments. First, a committee statement that a particular law and all "applicable" laws should continue to apply in accordance with their terms adds nothing to the general body of legal wisdom. Obviously an Act applies to whatever it applies to, but the germane point in relation to the Federal Aviation Act is that it embodies not only a program of regulation but also a program of exemption. The CAB is bound to administer both as sound policy may dictate.[10] "If possible, all sections of the Act must be reconciled so as to produce a symmetrical whole." *Federal Power Commission* v. *Panhandle Eastern Pipeline Co.*, 337 U.S. 498, 514 (1949); *Richards* v. *United States*, 369 U.S. 1, 11 (1962).

Administrative bodies may not pick and choose their favorite statutory provisions or even their favorite statutes, but must heed the entire body of laws and policies which affect their functions. As stated in *Southern Steamship Co.* v. *N.L.R.B.*, 316 U.S. 31, 47 (1942):

> "It is sufficient for this case to observe that the Board has not been commissioned to effectuate the policies of the Labor Relations Act so single-mindedly that it may wholly ignore other and equally important Congressional objectives. Frequently the entire scope of Congressional purpose calls for careful accommodation of one statutory scheme to another, and it is not too much to demand of an administrative body that it undertake

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[10] The CAB was recently reminded that even a presidential preference for a particular result could not control the performance of the Board's statutory duties. Western Airlines, Inc. v. CAB, 351 F. 2d 778, 782 (D.C. Cir., 1965)

this accommodation without excessive emphasis upon its immediate task."

The CAB reasonably may be asked, under this doctrine, to accord a measure of recognition to the basic constitutional distribution of functions between the states and the nation by noting that states have presumptive power over intrastate commerce and that the commerce here involved is intrastate in every substantial sense. In any event, if agencies may be asked to sensitize themselves to the overtones of laws they do not administer, they are the more clearly required to apply as entireties the laws they do administer. No Congressional committee can extinguish that duty.

Our second observation on the Committee report is that even if the Committee could have foreclosed the issue of exemption, it made no such attempt. Any inference that the Committee was anti-exemption as regards intra-Hawaiian air commerce is dispelled by the memoranda which it cited approvingly in Appendix F to its report.[11] Those memoranda indicate: (i) that intrastate *maritime* commerce is of no federal concern;[12] (ii) that Hawaiian interisland transportation generally is local in the sense which admits of state regulation under *Wilmington Transportation Co.* v. *California R.R. Comm.*, 236 U.S. 151 (1915) (discussed in Island's petition, R. 19) if discrimination is avoided and Congress has not acted inconsistently;[13] (iii) that Hawaii could tax the total gross receipts from interisland transportation even though it traversed the high seas;[14] and (iv) Hawaii could tax sales of goods in interisland commerce even though they were to move across international waters in the course of delivery.[15] All of

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[11] U.S. Cong. & Admin. News, 86th Cong., 1st Sess., pp. 1408-11.

[12] Id., p. 1408.

[13] Id., p. 1409.

[14] Id., p. 1410.

[15] Id., p. 1411.

these activities would, of course, be strictly forbidden if interisland transportation constituted interstate (or foreign) commerce in any substantive sense. *Covington & C. Bridge Co.* v. *Kentucky,* 154 U.S. 204 (1894); *Wabash, St. L. & P. Ry. Co.* v. *Illinois,* 118 U.S. 557 (1886); *Crandall* v. *Nevada,* 73 U.S. 35 (1868). Having thus established the slightness of the federal interest in interisland commerce, the Committee report cannot fairly be read in denigration of the Board's exemptive power.

4. Irrelevance of Subsidies and Losses

While the CAB's reliance on subsidy is great, explanation of its relevance is missing. The order said, relative to subsidy (and operating losses) only this (R. 168(a)):

> "In addition, the Federal Government has a substantial interest in the problems of interisland air transportation, which could[16] be adversely affected by the exemption requested. Since 1949 it has paid $6,377,000 in subsidy to the two interisland carriers. Aloha estimates that Island's proposed service would divert $1,000,000 annual revenue from Aloha, and Hawaiian estimates that the two subsidized carriers would lose an additional $4,856,000 annually as a result of Island's service. These diversion estimates are based on Island's service alone, while the application presents the possibility of an even greater number of additional carriers in the market. Under these circumstances, it would not be in the public interest to grant exemption authority permitting a carrier or carriers to operate in direct competition with Aloha and Hawaiian."

The order contains no explanation as to how the public interest—present or future—is affected by a federal expenditure of $6,377,000 over a past period of seventeen years. What the order implies is that since subsidy has been paid for many years, the public interest requires its continuance in perpetuity by excluding competitors who

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[16] "Could" rather than "would". The Board's propensity for fearing the worst is an inadequate substitute for findings of fact.

would serve the intra-Hawaiian trade unsubsidized. The CAB seems to be announcing that it can buy federal jurisdiction with a monetary grant and that jurisdiction so bought must roll eternally onward through its own momentum. Implicit in this position is the assumption that the public interest in maintaining federal jurisdiction is proportionate to the size of prior expenditures. From this follows the conclusion that big subsidies already paid call for big subsidies hereafter to be paid. A more inventively warped concept of the public interest would be hard to contrive.

The above-quoted excerpt switches in midpassage from past subsidies paid by the government to future losses predicted by the carrier beneficiaries. The relevance of these prophecies[17] is obscure. If a relationship exists between future losses and future subsidies, it is undisclosed. If the CAB is suggesting that it has a commitment to match bigger losses with bigger subsidies regardless of circumstance, we again suggest that its concept of the public interest demands correction.

5. The Concept of Public Interest

(a) The Present Monopoly

The CAB order states three times, with prodigal monotony, that the exemption sought would not be in the public interest—without once confiding its official view of that exalted concept. We find a hint on the face of the order as to what the public interest *excludes,* viz.: competition with carriers which have received large subsidies for long periods, and competition with carriers who tout their corporate anemia by boasting of their chronic losses (R. 61). Some clues to the Board's affirmative philosophy may be sought with reward in the interveners' pleadings since the Board's order constitutes a summary adoption of

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[17] We continue to emphasize that they are only prophecies, and to contend that the Board could not lawfully accept them without supporting proof.

their contentions. A position deserving of bonus points for originality is Hawaiian's lament (R. 61) that Hawaiian and Aloha have experienced slow growth "due to the unique situation of having no surface traffic from which to divert passengers." With the euphemism sifted out, this means that Hawaiian and Aloha are stymied by the completeness of their monopoly and must therefore be saved from competitors on the ground that having no new worlds to conquer, they have none to share. The CAB agrees—and explains its agreement in terms of the public interest. Thus, in the Board's concept, the public interest means the preservation of monopoly.

Further, it means the preservation of monopoly for carriers whose own operations have never in any substantial sense met the current tests of the Act as to public convenience and necessity. Born in the days of federal overlordship of Hawaii as a territory, both carriers were held to be required in the interest of the island archipelago's *domestic* commerce—an interest which the Board lost with the passage of the statehood act. The jurisdiction which remains to it—either true interstate commerce or commerce of the fictitious variety which the Board would apply to bar petitioner—has never been applied to Hawaiian or Aloha. Hawaiian received a grandfather certificate in 1939 (R. 14). Aloha was later certified (1948) without subsidy solely because Hawaiian was a monopolist whose island public needed the benefits of competition (R. 14-15). Aloha was then subsidized (1951) to keep it alive as a competitor (R. 15-16)—all in the local interest of Hawaii as a territory. In 1955 the CAB imposed a service cutback to conserve subsidy funds (R. 17-18)—whereupon the subsidy initially granted to promote service became the cause of its contraction and—in the present case—the excuse for depriving Hawaii of Island's economy service which the state wants and needs and which its government demands the right to sponsor.

We submit that the Board's approach is fatally defective when it overrides Hawaii's officially-expressed need for Island's service, in order to make competition-proof two carriers who have never passed the public convenience test in the past and are not asked to pass it here. In the CAB view, Hawaiian and Aloha have only to prove that, like Mt. Everest, they are there; and proving this, they render themselves—unlike Mt. Everest—impregnable. We should suppose that if monopoly is to be automatically equated with the public interest, proof should be demanded that, at the least, the monopoly involved was a good monopoly. Such proof is lacking here.

(b) The Effect of Statehood

When Hawaiian and Aloha were certified and subsidized, Hawaii was a territory and the United States stood in the relationship of *parens patriae:* the federal government was the local government of Hawaii. The CAB certification and subsidy proceedings relative to Hawaiian and Aloha were conducted and decided in terms of Hawaii's local needs as appraised by the United States as the local governing authority (R. 13-18). With statehood, the basis of federal—and CAB—jurisdiction changed. The federal government surrendered its local guardianship by admitting Hawaii to the Federal Union "on an equal footing with the other states in all respects whatever."[18] Hawaii then became the master of its local affairs and the guardian of its local interests—subject, in aviation matters, to the federal reservation of a highly technical jurisdiction resulting from the geographic accident of Hawaii's archipelagic design. As the CAB has observed in its own decisions (R. 13-16), Hawaii's geography is meaningful primarily as the cause of Hawaii's local dependence on air transport. The Hawaii legislature has also emphasized to the CAB in this case the local importance of such transportation to the Hawaiian community and the failure of

[18] Hawaiian Statehood Act, § 1, Pub. Law 86-3, 73 Stat. 4.

existing airlines to meet the community need for "low cost, frill-free" service (R. 30-35). It has also emphasized Hawaii's need, as a state, to provide for such service "on a footing of practical equality with the other states so far as its relations to the federal government in the aeronautical field are concerned at least to the extent that a classification of purely intrastate nonfederal public air carriers may be established by virtue of state authority" (R. 33).

We can think of no questions of fact or law more clearly related to the public interest than those which bear on the relationship between the states and the United States. The problem of state-federal relationships, conflicts and adjustments is high on the list of topics which have absorbed the Supreme Court's attention since the formation of the Union. *Gibbons* v. *Ogden,* 22 U.S. 1 (1824); *Leiter Minerals* v. *United States,* 352 U.S. 220, 223 (1957); *Sears Roebuck Co.* v. *Stiffel Co.,* 376 U.S. 225, 228 (1964); *United States* v. *Shimer,* 367 U.S. 374 (1961); *Polar Ice Cream & Creamery Co.* v. *Andrews,* 375 U.S. 361, 373 (1964). Moreover, the Court has admonished that "in ascertaining the scope of congressional legislation a due regard for a proper adjustment of the local and national interests in our federal scheme must always be in the background . . ." *Federal Trade Commission* v. *Bunte Bros.,* 312 U.S. 349, 351 (1941). In *Palmer* v. *Massachusetts,* 308 U.S. 79, 84 (1939), the Court said:

> "To be sure, in recent years Congress has from time to time exercised authority over purely intrastate activities of an interstate carrier when, in the judgment of Congress, an interstate carrier constituted, as a matter of economic fact, a single organism and could not effectively be regulated as to some of its interstate phases without drawing local business within the regulated sphere. But such absorption of state authority is a delicate exercise of legislative policy in achieving a wise accommodation between the needs of central control and the lively maintenance of local institutions. Therefore in construing legislation, this

> court has disfavored in-roads by implication on state authority and resolutely confined restrictions upon the traditional power of states to regulate their local transportation to the plain mandate of Congress."[19]

Since the statute which the CAB administers authorizes exemption of carriers in the public interest, the CAB reasonably may be asked to consider whether use of the exempting power should not at least be pondered, relative to intra-Hawaiian transactions, in aid of "the lively maintenance of local institutions." The Board, we contend, committed flagrant error in refusing even passing notice of the state's contention that the public interest called for preservation of local power over local commerce. Hawaii cited to the Board "a strong and unsatisfied demand by the people of this State" for low cost transportation "which the existing carriers have not furnished." It emphasized the "impracticability of all other competitive means of intercity transportation" in Hawaii. It told the Board that "Hawaii alone of all the fifty states is prevented from dealing with this intrastate matter" in the absence of exemption. These are formidable matters "of primary and pressing concern to the State of Hawaii" (R. 33). We submit that when a state charges suffocation by the Board of a state power which the state needs for its well-being and which all other states possess, the minimum acceptable response is an examination of the facts—rather than a sullen refusal even to ponder the state's necessity, or a bland explication that carriers which have never proved their virtue must be sheltered from competition in every event.

The courts have long insisted that state police powers be treated with federal deference. In *Sinnott* v. *Davenport*, 63 U.S. 227, 243 (1859), the Court said:

> "We agree, that in the application of this principle of supremacy of an act of Congress in a case where

[19] To like effect see Davies Warehouse Co. v. Bowles, 321 U.S. 144, 154 (1944).

> the state law is but an exercise of a reserved power, the repugnance or conflict should be direct and positive, so that the two acts could not be reconciled or consistently stand together . . .''[20]

"[J]udicial deference to state action requires, whenever possible, that a state not be thwarted in its policy." *Tank Truck Rentals* v. *Commissioner,* 356 U.S. 30, 35 (1958). "It should never be held that Congress intends to supersede, or by its legislation suspend, the exercise of the police powers of the states, even when it may do so, unless its purpose to effect that result is clearly manifested." *Reid* v. *Colorado,* 187 U.S. 137, 149 (1903); *Kelly* v. *State of Washington,* 302 U.S. 1, 11 (1937). See also *Missouri Pacific R. Co.* v. *Norwood,* 283 U.S. 249, 256 (1931); *Brotherhood of Locomotive Engineers* v. *Chicago, R. I. & P. R.R. Co.,* — U.S. —, 34 L.W. 4103, 4104 (1966).

A solid body of authority thus establishes that powers inherent in state government merit Congressional respect and forebearance. The same body of authority shows that federal courts establish no facile presumptions in favor of the extinction of state powers by cavalier measures of federal supersession.

If the Federal Aviation Act contained no exemption authority, we would have to concede, at least as a matter of construction, that it superseded Hawaii's police power over its internal commerce. Since it *does* contain exemption provisions, no such supersession need be inferred—or should be. To apply § 416(b) grudgingly or narrowly is to flout the *Tank Truck* mandate that "whenever possible . . . a state not be thwarted in its policy."

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[20] Quoted and followed in Kelly v. State of Washington, 302 U.S. 1, 10 (1937).

(c) The Commerce Involved and the Policy of the Federal Aviation Act

This Court's decision in *Island Airlines* v. *C.A.B.*, 352 F. 2d 735 (1965), perhaps forecloses any contention that Hawaiian interisland commerce is not interstate commerce in the technical sense for purposes of federal jurisdiction if the federal government insists on exercising such jurisdiction.[21] It does not in any sense foreclose inquiry as to whether the federal government does so insist, or should. That it does not so insist is established by the inclusion of exemptive authority in the Act. That it should not so insist is established by the broad policies of the Act itself, considered in the light of the power-distribution scheme of the federal Constitution.

Under the Constitution (Art. 1, § 8), the Congress has power to regulate commerce "with foreign Nations, and among the several States, and with the Indian Tribes." The states were at an early date excluded from any regulation of such commerce which conflicted with the constitutional grant to the federal government, or with federal laws enacted thereunder. *Gibbons* v. *Ogden*, 22 U.S. 1 (1824). But state powers over commerce—including interstate and foreign—exercisable without impairment of the federal grant, were rigorously protected. *Cooley* v. *Board of Wardens*, 53 U.S. 299 (1851). The decisions heretofore cited (*supra*, pp. 16-17) show a strong and steady current

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[21] Apparently it is "interstate" under the definition in § 101(20)(a) of the Federal Aviation Act (49 U.S.C. 1301(20)(a)) even though no second state is involved. On the other hand, the voyage from San Francisco to San Diego in Lord v. Goodall, 102 U.S. 541, 544 (1881) on which rests whatever jurisdiction the federal government has over intra-Hawaiian commerce between the islands, was held to be a voyage "in commerce with foreign Nations." This raises a perplexing problem because interisland commerce is *not* "foreign air commerce" or foreign air transportation under the definitions of the Federal Aviation Act (§ 101(20)(c), 49 U.S.C. 1301(20)(c), and § 101(21)(c), 49 U.S.C. 1301(21)(c)). If it is not foreign commerce under the Act and not interstate commerce under the Constitution, the basis of federal jurisdiction disappears. We urge this view upon the Court if the jurisdictional issue is still open under Island Airlines v. C.A.B., 352 F. 2d 735.

of reluctance to extinguish state police (i.e., regulatory) powers by presumption or implication of federal supersession.

The Federal Aviation Act incorporates a regulatory design which in all respects emphasizes its concern with interstate and foreign commerce and with the promotion and regulation of a national and international—as distinguished from local—aviation industry. Thus, § 101 (10) (49 U.S.C. 1301 (10)) defines air transportation as meaning "interstate, overseas, or foreign" air transportation "or the transportation of mail by aircraft." Interstate air transportation is defined in § 101 (21) (49 U.S.C. 1301 (21)) as transportation in commerce between places in different states, or within U. S. territories or the District of Columbia, and—

> "between places in the same State of the United States through the airspace over any place outside thereof."

The same subsection defines overseas air transportation as carriage in commerce between the U. S. mainland and its territories or between territories; and defines foreign air transportation as carriage in commerce between the United States and places outside thereof.

Every detail of this definitional pattern relates to interstate or international or intraterritorial commerce except the indented quotation extending the "interstate" definition to flights between places in the same state through airspace over a place outside. When the present Act was passed in 1958 (and its predecessor Act in 1938), Hawaii had not become a state. The country was a solid composite of contiguous states and the provision relative to flights between places in a state through a place outside described for every practical purpose a genuine interstate situation—e.g., a flight starting in state A, traversing state B, and ending in state A. No state then in the Union presented the problem which confronts Hawaii of *neces-*

sitating flight beyond its borders in order to complete an intrastate movement of substantial state importance. Consequently the Congress could hardly have considered that it was legislating out of existence any state's power over its intrastate air commerce.

Aside from the matter of definition, the Act as a whole is incompatible with any such parochial application as the CAB has here attempted. Section 102 (49 U.S.C. § 1302) sets forth a declaration of policy for the Board, listing matters which the Board is to consider as in the public convenience and necessity. These include the encouragement and development of an air transportation system adapted to the present and future needs of "the foreign and domestic commerce of the United States, of the Postal Service, and of the National defense"; the assurance of safety and fostering of sound economics in "such transportation"; competition necessary to sound development "of an air-transportation system properly adapted to the needs of the foreign and domestic commerce of the United States, of the Postal Service, and of the national defense." Section 401 (49 U.S.C. 1371) provides for issuance of certificates to engage in air transportation on the basis of public convenience and necessity (as thus spelled out). Section 406(b), 49 U.S.C. 1376(b), permits mail pay scaled to promote service "of the character and quality required for the commerce of the United States, the Postal Service, and the national defense."

Section 416, 49 U.S.C. 1386, authorizes the CAB to establish various classifications of air carriers, and to exempt carriers or classes, wholly or in part, from economic regulation if it finds:

(i) That enforcement would be an undue burden on the carrier (or class) "by reason of the limited extent of, or unusual circumstances affecting" the carrier or class; and

(ii) Enforcement is not in the public interest.

These provisions collectively show that the Act was not designed to regulate the local and isolated service proposed by Island under state auspices and solely between places in a state constituting a detached community thousands of miles from the U. S. mainland. The service proposed by Island is not geared into "the foreign and domestic commerce of the United States" since it will serve only the local commerce of Hawaii. It is not geared into the Postal Service because it will carry no mail. It is not geared into the defense establishment because it is planned merely as a civilian service, not coordinated with any military function. It is, in short, not a part of the national air transportation system to which the mandate of the CAB is directed and limited. Even a proposal for direct service between the U. S. mainland and the outer Hawaiian islands was disapproved by the CAB because it did not fit into the agency's "system" concept. *Hawaiian Common Fares Case,* 10 C.A.B. 921 (1949). (R. 17).

Island's is not the only service which differs from those which the Act was meant to regulate; so, too, since statehood, do those of Hawaiian and Aloha. Neither (as we have noted above) has proved, under the conditions of Hawaiian statehood, a case of public convenience and necessity; quite possibly neither could. Nevertheless, both have been covered with an impenetrable blanket of competitive immunity on grounds of an earlier public interest which the CAB has never reviewed since the change in Hawaii's status and which now is exclusively Hawaii's function to determine.

That the Act contemplates a residuum of state control over aviation is indicated by section 204 (b) (49 U.S.C. 1324 (b)) which provides for CAB cooperation (including joint hearings) with state agencies "in connection with any matter arising under this Act within its jurisdiction, and to avail itself of the cooperation . . . of such State agencies as fully as may be practicable . . ." Instead

of cooperating with Hawaii in a matter of vital State concern, the CAB proceeded in cynical defiance of the state, first by securing an injunction against the carrier whose operation the state had authorized, and thereafter by disregarding the state's exemption petitions attesting its urgent local needs.

The Board's ultimate findings—all in conclusory form following the statutory language—were that Island had failed to show (i) that enforcement of the Act would be an undue burden due to the limited extent of Island's operations or unusual circumstances affecting them; and (ii) that enforcement would not be in the public interest. It was wrong on all aspects of both conclusions.

We claim that the burden of a certification proceeding is undue if the proceeding is foredoomed because the Act does not cover the service described. That, we submit, is the present case. Island is not proposing a service susceptible to integration into a national air transportation system. It is not proposing to engage in the foreign or domestic commerce of the United States but in the local commerce of the State of Hawaii. It will not carry mail (and is not authorized to do so), nor has it any national defense attributes. If the service is not within the Board's authority to certify, it is not within the Board's authority to exclude, and any obligatory proceeding to invoke Board action beyond its powers would be an undue burden.

Not only would the burden of a certification case be inherently undue; it would be so on account of the limited extent of the Island service proposed and the unusual circumstances affecting it. The limited extent—including the isolated locale—of the service has been discussed above. "Unusual circumstances" are abundantly present in the geography of Hawaii and its constitutional consequences—both of which are not only unusual but unique—and so characterized by the committee which reported the Hawaii statehood bill (R. 53). The CAB in refusing to detect

unusualness of circumstance in a situation which lacks a counterpart in the Board's regulatory universe is setting an unattainable standard of unusuality.

(d) The Federal Fisc

While the rationale of the order under review is subluminous, the provisions emphasizing the extent of past subsidies to Hawaiian and Aloha and their prospect of future losses imply that the CAB purported to act in the role of fiscal guardian to the federal government. More specifically, the CAB seemed to be annulling Hawaii's power to regulate its internal commerce because such annulment would make life cheaper for the federal government.[22] We contend that Island's right to engage in intra-Hawaiian commerce and Hawaii's right to regulate such commerce are not exterminable for that reason.

Penn Dairies v. *Milk Control Commission,* 318 U.S. 261 (1943), held in particular that Pennsylvania's commission-fixed minimum prices for milk were applicable to purchases in the state by the federal government; and held in general that state regulatory power is not curtailed or extinguished because it increases the federal government's cost of doing business. Among the Court's quotable pronouncements are the following (318 U.S. at 269, 270-71, 275):

> ". . . the mere fact that non-discriminatory taxation or regulation of the contractor imposes an increased economic burden on the government is no longer regarded as bringing the contractor within any implied immunity of the government from state taxation or regulation."
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22 The Board could have reasoned that: (a) past subsidy would look prodigal if its beneficiaries were not perpetuated; (b) federal loan guarantees for Hawaiian and Aloha might have to be met if those carriers should fail; (c) future losses would have to be offset by future subsidies. Only by a blind attribution to the Board of some such reasoning process can any relationship be detected between the Board's conclusions and its unrevealed concept of public interest.

"We have recognized that the Constitution presupposes the continued existence of the states functioning in coordination with the national government, with authority in the states to lay taxes and to regulate their internal affairs and policy, and that state regulation like state taxation inevitably imposes some burdens on the national government of the same kind as those imposed on citizens of the United States within the state's borders, see *Metcalf & Eddy* v. *Mitchell, supra,* 269 U.S. at pages 523, 524, 46 S. Ct. at page 174, 70 L. Ed. 384. And we have held that those burdens, save as Congress may act to remove them, are to be regarded as the normal incidents of the operation within the same territory of a dual system of government, and that no immunity of the national government from such burdens is to be implied from the Constitution which established the system, see *Graves* v. *People of the State of New York ex rel. O'Keefe,* 306 U.S. 466, 483, 487, 59 S. Ct. 595, 599, 601, 86 L. Ed. 927, 120 A.I.R. 1466."

* * *

"Considerations which lead us not to favor repeal of statutes by implication [citations] should be at least as persuasive when the question is one of the nullification of state power by Congressional legislation."

* * *

"Furthermore we should be slow to strike down legislation which the state concededly had power to enact, because of its asserted burden on the federal government. For the state is powerless to remove the ill effects of our decision, while the national government, which has the ultimate power, remains free to remove the burden."

In *Penn Dairies,* the state regulation impinged directly on the cost of federal procurement. The federal government had no choice but to pay the regulated price if it bought any Pennsylvania milk. Nevertheless the Court spoke (and ruled) strongly against invalidation of state regulation unless it discriminates against a federal activity or conflicts with a federal law. In the present case, Hawaii has taken no action which directly affects any cost of any

federal activity, and none which could do so even indirectly unless the federal government voluntarily should choose to react by escalating its activities as salvor of the two existing (and ailing) airlines in the event their revenues should suffer from Island's competition—a prospect which we contest for reasons hereafter noted.

(e) Exemption Precedents—CAB

Two CAB exemption actions—the *Catalina Island Service Investigation,* Order No. E-19678 (1963), and *Application of Starflite Inc.,* Order No. E-21535 (1964)—offering relevantly close parallels to the present application are discussed in the Island petition (R. 24-25). The *Starflite* application, terminating in CAB order No. E-21535, offers particularly strong support for the relief sought by Island. In that case the applicant had been conducting an intrastate operation between East Hampton, Long Island and La Guardia Airport. Service had been performed on a regular basis with DC-3 aircraft but was confined to weather conditions governed by visual flight regulations. The reason for this restriction was that instrument traffic patterns into La Guardia would require the carrier to fly outside the confines of the State of New York and thereby force it to engage in interstate air commerce. The CAB granted the exemption sought by Starflite stating in part:

> "The authority sought is extremely limited, covering only flights between points situated in the same state which occasionally, because of weather conditions, involve navigation over air space outside of the state. Grant of exemption herein will not permit the carrier to expand the geographic area it may already serve on intrastate operations; it will, however, enable the carrier to use alternate IFR routings when VFR operations are not permissible. Under the circumstances, we find that grant of the exemption sought is in the public interest.
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> In reaching its conclusion the Board has taken into account, as considerations which warrant use of its

> exemption power, the limited nature of the authority granted herein, the relatively small size and restricted nature of the applicant's operations, and the unusual flight pattern situation necessitating an exemption in this instance. To require a certification proceeding in order to conduct the proposed operations would be disproportionate to the size of the operations, unduly burdensome on the carrier, and not in the public interest."

The only conceivably-pertinent difference between *Starflite* and the Island application was that in the former, "No certificated route carrier is authorized to provide air service between East Hampton and La Guardia; hence it appears that no significant adverse effect upon any other air carrier would result from grant of the exemption"—whereas in Hawaii, there are, as noted, two certificated carriers in intra-Hawaiian commerce, but the CAB conducted no proceedings permitting it to know or to find that Island would hurt them. Further, a potential loss of traffic by either of such carriers cannot be equated with harm to the public interest where their own certificates were issued under superseded conditions (i.e., when Hawaii was a territory) and have never been reexamined in the light of current certification requirements.

Except for the distinction noted, virtually every condition found in *Starflite* and cited in support of exemption is present in this case, and equally merits citation in support of exemption. There, as here, flights were "between points situated in the same state." There, as here, the flights involved "navigation over air space outside of the state."[23] There, as here, "exemption . . . will not permit the carrier to expand the geographic area it may already

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[23] Starflite was forced outside the state by meteorology; Island by geography. What is the legal distinction? Starflito's use of outside air space was occasional (depending on the frequency of bad weather); Island must always use outside air space. Again, what is the legal distinction? In what respect is the interest of the U.S. in interstate commerce differently affected because a carrier uses outside air space for convenience rather than through necessity?

serve on intrastate operations." There, as here, the applicant's service was of "relatively small and restricted nature." There, as here, the service involved an "unusual flight plan situation necessitating an exemption." There, as here, the burden of certification proceedings "would be disproportionate to the size of the operations, unduly burdensome on the carrier, and not in the public interest."

In *Starflite,* each of the enumerated conditions pointed towards exemption. In *Island,* the equivalent conditions were held to point the other way. The difference is unexplainable except as a manifestation of pure caprice.

(f) An Exemption Precedent—ICC

In *Motor Carrier Operation in the State of Hawaii* (Ex *Parte* No. MC-59, 1960), 84 M.C.C. 5, the Interstate Commerce Commission considered whether to exempt the operations in Hawaii, after statehood, of motor carriers engaged in interstate or foreign commerce. The applicable provision of the Interstate Commerce Act was section 204(a)(4a) (49 U.S.C. 304(a)(4a)), which requires the ICC—

> "To determine * * * whether the transportation in interstate or foreign commerce performed by any motor carrier or class of motor carriers lawfully engaged in operation solely within a single State is in fact of such nature, character, or quantity as not substantially to affect or impair uniform regulation by the Commission of transportation by motor carriers engaged in interstate or foreign commerce in effectuating the national transportation policy declared in this Act. Upon so finding, the Commission shall issue a certificate of exemption to such motor carrier or class of motor carriers . . ."

The procedure followed by the ICC in passing on the question of exemption was in notable contrast to the procedure—or absence of procedure—of the CAB in this case. As described by the ICC (84 MCC at 6):

". . . we instituted the instant proceeding in order to develop an adequate record to determine [the statutory issues] . . . Our order provided an opportunity for all interested parties to be heard at oral hearings at Honolulu, Hawaii, and Washington, D. C., and also permitted the filing of written statements of data, views, and arguments respecting these matters."

The report then describes the hearings and recites the receipt of briefs, statements of fact and argument, all of which are then examined in a printed opinion covering 28 closely printed pages. Upon this exhaustive review, the Commission determined to grant a blanket exemption. The following quotation represents a summary of the agency's reasoning:

"The situation with respect to Hawaii is unique. Unlike other States it does not border on any State or foreign country; indeed, its shores are more than 2,000 miles from the mainland. Even Alaska, with which Hawaii is sometimes compared regarding transport regulation, has a highway connection with the other continental States and Canda over which motor-carrier operations take place; additionally, almost all water traffic in the Alaska trade is transported by carriers operating solely between Alaska and the other Pacific Coast States, whereas much of the water transportation between the mainland and Hawaii is by water carriers also engaged in foreign commerce. Apart from its physical isolation from the mainland and the remoteness of most of its motor carriers from the operations of other carriers subject to our jurisdiction, Hawaii's component parts are separated by expanses of water ranging from 25 to 70 miles in width, and its terrain is extremely mountainous in character, geographical features which necessarily limit motor transportation to relatively short distances. Additionally, nearly 80 percent of the population of Hawaii is concentrated in one incorporated community over whose docks the greater portion of the interstate traffic moves, and because of our lack of jurisdiction over water carriers operating between the continental States and Hawaii, we are without authority to approve the

establishment of through routes and joint rates between such water carriers and the motor carriers operating in Hawaii or on the mainland.

Considering all factors, we are persuaded that the exercise of our jurisdiction in the regulation of Hawaiian motor carriers, whose operations in large part might well be characterized as in the nature of pickup and delivery (particularly as to inbound traffic, a large portion of which comes to rest at the ports), would amount to unwarranted Federal regulation of a stub ended, essentially local, operation for no useful purpose."

The question for the ICC was substantially similar to that of the CAB here. In each instance, the basic question was whether small and essentially local transport operations in a state isolated by over 2,000 miles from the U. S. mainland were so far integrated into a national pattern of interstate or foreign commerce as to call for coordinated regulation under a federal master plan. The ICC said no, on the basis of searching investigation and meticulous fact-finding. The CAB said yes, on the basis of no investigation, no fact-finding, and obdurate refusal to consider the matters submitted to it. The ICC method was right; the CAB wrong. The principal difference between Ex Parte MC-59 and this case is that the commerce covered by the ICC exemption was clearly *interstate* commerce in the true sense of commerce moving between one state and another; whereas the commerce covered by the CAB refusal of exemption is purely commerce moving between places in the same state.

B. DENIAL OF EXEMPTION DEPRIVES THE STATE OF HAWAII OF "EQUAL FOOTING" IN THE FEDERAL UNION

The Hawaiian Statehood Act, Pub. Law 86-3, (73 Stat. 4) admitted Hawaii "into the Union on an equal footing with the other States in all respects whatever . . ." (§ 1). The Act provided (§ 15) that any territorial law enacted by the Congress—i.e., a law whose validity depended on

congressional authority to govern Hawaii as a territory—should remain in force for two years after admission, or until Hawaii should amend or repeal it.

The act admitting Alaska as a state contained equivalent provisions. They came before a three-judge district court in *Interior Airways* v. *Wien Alaska Airlines,* 188 F. Supp. 107 (D.C. Alaska, 1960), in an injunction suit to restrain Wien from prosecuting and the CAB from entertaining a complaint proceeding against Interior, covering activities during the two-year period when various federal statutes continued in effect as "territorial laws." The suit rested on the contention that Interior was engaged only in intrastate commerce in Alaska and that the CAB therefore lacked jurisdiction. Interior claimed, on the basis of *Coyle* v. *Smith,* 221 U.S. 559 (1911), that federal regulation of its intrastate activity would deprive Alaska of control over its intrastate commerce in violation of the equal-footing provision of the Alaska statehood act. The Interior contention was rejected—but solely on the ground that the CAB was asserting jurisdiction during the two-year interval in which the Federal Aviation Act remained in force by choice of Alaska itself, which could have superseded the Act at any time by passing its own aviation statute. The Court treated Alaska's purposeful nonadoption of a superseding law as an adoption by the state of federal law for the transitional period, and concluded that this involved no impairment of Alaskan sovereignty. The opinion contains the following observations:

> "There is no question but that the authority for the regulation of intrastate air commerce by the Civil Aeronautics Board is authorized, if at all, solely by such 'Territorial laws.' We hold that Sec. 401(a) of the Federal Aviation Act of 1958 is such a law." (188 F. Supp. at 111)
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> * * *
>
> "We cannot read Coyle as dispositive of the issue. We agree that under Coyle, and under the cases discussed

> in some detail therein, as well as those cases since determined by the Supreme Court, no state can be deprived of any 'attributes of power essential to its equality with other states.' The essence of the power of statehood must be maintained without impairment by any condition of admission, compact, or agreement. A state cannot be restricted in its legislative power in respect of any matter which is not plainly within the regulatory power of the national government. 'Each state must be competent to exercise that residuum of sovereignty not delegated to the United States by the constitution.' What is prohibited is not *all* conditions, compacts, or stipulations, but only those which would not be valid and effectual if the subject of Congressional legislation after the state's admission.
>
> Here we find no deprivation of any of Alaska's power. She could and can terminate the regulation of intrastate air commerce by the Federal Government at any time she chooses to act." (188 F. Supp. at 112)

The case thus turned on a matter of timing—i.e., the exertion of CAB power during the transitional period when territorial laws remained in force by the state's decision. The clear portent is that if the CAB had tried to flex its intrastate muscles *after* the transition, it would have infringed Alaska's equal footing as expounded in *Coyle* v. *Smith.*

That case held that under the equal footing provision of the Oklahoma admission act, the state could establish its capital in any location of its choice despite a provision in the act that the capital be at Guthrie until a date specified. The opinion contained the following presently-relevant pronouncements:

> "So far as this court has found occasion to advert to the effect of enabling acts as affirmative legislation affecting the power of new states after admission, there is to be found no sanction for the contention that any state may be deprived of any of the power constitutionally possessed by other states, as states, by

reason of the terms in which the act admitting them to the Union have been framed." (221 at 570)

* * *

"The plain deduction from this case [Pollard v. Hagan, 3 How. 212] is that when a new state is admitted into the Union, it is so admitted with all of the powers of sovereignty and jurisdiction which pertain to the original states, and that such powers may not be constitutionally diminished, impaired, or shorn away by any conditions, compacts, or stipulations embraced in the act under which the new state came into the Union, which would not be valid and effectual if the subject of congressional legislation after admission." (221 U.S. at 573)

* * *

"It may well happen that Congress should embrace in an enactment introducing a new state into the Union legislation intended as a regulation of commerce among the states, or with Indian tribes situated within the limits of such new state, or regulations touching the sole care and disposition of the public lands or reservations therein, which might be upheld as legislation within the sphere of the plain power of Congress. But in every such case such legislation would derive its force not from any agreement or compact with the proposed new state, nor by reason of its acceptance of such enactment as a term of admission, but solely because the power of Congress extended to the subject, and therefore would not operate to restrict the state's legislative power in respect of any matter which was not plainly within the regulating power of Congress." (221 U.S. 574)

The CAB position (R. 168(a) - 168(b)) is that the Congress, "in enacting the Hawaiian Statehood Bill . . . fully considered the regulatory problem and determined that because of the geographic situation, Federal regulation of the interisland air transportation should continue. This Congressional determination is dispositive of Island's contention."

We understand this to mean that the committee comments on the admission bill (see pp. 8-9, *supra*) are to be taken as grafts on the admission legislation itself, having the effect of exterminating Hawaii's control of its intra-Hawaii air commerce because of the state's insular physical structure. The Board could hardly make a clearer case in derogation of the new state's equal footing, or one more pointedly at odds with *Coyle* v. *Smith.*

We make no claim that the Federal Aviation Act is in all circumstances unconstitutional as applied to Hawaiian interisland commerce, but note that "a law which is constitutional as applied in one manner may . . . violate the constitution when applied in another," *Alabama State Federation of Labor* v. *McAdory,* 325 U.S. 450, 462 (1945); and that "the constitutionality of a statute, valid on its face, may be assailed by proof of facts tending to show that the statute as applied to a particular article is without support in reason because the article, although within the prohibited class, is so different from others of the class as to be without the reason for the prohibition." *United States* v. *Carolene Products Co.,* 304 U.S. 144, 153 (1938).

The CAB has here applied the Federal Aviation Act not to an "article" but to a situation "so different from others of the class as to be without the reason" of the statute's regulatory scheme. Hawaii's situation reaches the ultimate extreme of difference from others to which the Act has been applied. The Board's unduplicated and unduplicable effort to regulate pure intra-Hawaii commerce not only stretches the commerce clause beyond its stretchable limit but negates Hawaii's—and only Hawaii's—position as an equal among equals. For that reason in addition to many others, the Board's action must be annulled.

C. THE BOARD'S PROCEDURE WAS UNLAWFUL AND ITS FINDINGS UNSUPPORTED

The CAB did not deny the petition for legal insufficiency of its own allegations. It received answering pleadings (R. 38-157) from the interveners which contested the petition and alleged new facts. Without affording any procedure for testing either the truth or legal sufficiency of the answers, the Board summarily denied (1) the Island petition; and (on the basis of such denial) (2) the supporting state and county petitions—in reliance on material alleged in the answers and uncritically accepted as true, without proof. This was error, involving a denial of constitutional due process and a failure to find the requisite facts. It was also prejudicial error because Island would have contested the material facts as alleged by interveners and the contest would have been more than formal. A single illustration will suffice.

The CAB found (R. 168(a)), on unsupported estimates based only on the *ipse dixit* of the interveners (whose estimates were themselves inconsistent) that Aloha would lose $1,000,000, and Aloha plus Hawaiian $4,856,000, in annual revenue to Island's lower-cost service. This finding was made in October, 1965.

Island would have shown, if permitted to do so, that in August, 1965 the Board published a staff study on "Traffic, Fares and Competition, Los Angeles-San Francisco Air Corridor"[24] which refutes dramatically the Board's finding here that low-fare competition diverts traffic and revenue without expanding either. We request the Court to notice this study officially.

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[24] Staff Research Report No. 4, Research and Statistics Division, Bureau of Accounts and Statistics, Civil Aeronautics Board, August, 1965. This study (less appendix) is annexed to this brief as Appendix B.

The focus of the Los Angeles-San Francisco study was the effect on that market of Pacific Southwest Airlines (PSA) of which the study states (p. 7):

> "A small intra-state carrier, Pacific Southwest Airlines, started service in 1949 with a single, rented DC-3. Always a very low-fare carrier, and operating up and down the coast between San Diego, Los Angeles, and San Francisco, PSA was once called 'The Poor Sailor's Airline'."

In other words, PSA was the California intrastate equivalent of Island.

The result of PSA's entry into the service on a low-cost basis is summarized thus:

> "With lower fares, PSA forged ahead in volume of traffic. But starting in 1962, the trunk airlines' determined competition in both quality of service and fares has brought them, together, equal with PSA in number of coach passengers. *And these competitive efforts have, undoubtedly, expanded total traffic far above what it might otherwise be.*" (p. 11; italics ours.)

> "PSA has thus appealed, successfully, to the large potential market—people who formerly traveled by other modes or did not travel at all." (p. 13.)[25]

> "Pacific Southwest Airlines' always-low fares have attracted traffic from competitors, have induced fare reductions by them, have brought down average fares and have apparently expanded total traffic far above with it might otherwise be." (p. 21.)

> "Since the market is price-elastic, further declines in fares would produce additional gross revenues for the carriers." (p. 23.)

Clearly, the functionaries who wrote the CAB order in the present case had never heard of the study. Since it invalidates the Board's basic factual assumption and the

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[25] This is a convincing answer to the assertion (R. 61) that Hawaii and Aloha cannot grow significantly because they now have all the existing traffic.

reason for making it, it is a critical item of proof and the Board could not lawfully foreclose Island from submitting it and arguing its meaning.[26]

Section 416(b) does not provide for a hearing on exemption applications, and it has been held that a "full" hearing is not required. *Eastern Airlines, Inc.* v. *Civil Aeronautics Board,* 185 F. 2d 426 (D.C. Cir. 1950), vacated as moot 341 U.S. 901. The case invites these observations:

1. The plaintiff was not the applicant for exemption but the applicant's competitor. A competitor's demand for a hearing raises merely a question of the competitor's standing. (185 F. 2d at 429)

2. Even so, the court said that a decision based on an *arbitrary* finding or belief "might not be enough and some proceedings may be necessary." (185 F. 2d at 428) It then noted that "In this case there were proceedings, in the course of which several verified documents were filed with the Board." (185 F. 2d at 428; see also note 4) *No such proceedings were had before the Board in Island.*

3. The court noted that even where no act of Congress requires a hearing, "the Administrative Procedure Act must be followed where a hearing is necessary

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[26] The PSA case has an interesting and relevant history. The Board while now citing PSA pridefully to prove the virtue of low rates, says nothing of early Board efforts to kill it off. The truth is that the CAB tried to drive PSA from the California skies in an attack paralleling its present campaign against Island. The jurisdictional basis for the suit against PSA was that some of its passengers came from or continued to places outside of California even though PSA stayed inside. A district court refused an injunction on the ground that the out-of-state passengers did not convert PSA service into interstate air transportation. Civil Aeronautics Board v. Friedkin Aeronautics, Inc. (S.D. Calif., 1954), 4 Avi. 17,457. This court reversed the decision and remanded it to the district court, Civil Aeronautics Board v. Friedkin Aeronautics, 246 F. 2d 173 (1957), to make requisite findings of fact as to the conditions of ticketing and handling out-of-state passengers. The CAB then dropped the case and PSA has operated to the present instant without molestation—and also without a CAB certificate or exemption order.

> to the protection of constitutional rights." (185 F. 2d at 428-29) But it then ruled that such a hearing was not available to a competitor—clearly implying that it *is* available to an applicant.

Cook Cleland Catalina Airways v. *Civil Aeronautics Board,* 195 F. 2d 206 (D.C. Cir., 1952), held that even an applicant was not there entitled to a hearing; it noted, however (195 F. 2d at 207):

> "The Board stated that it would consider as true and accurate all of the allegations of fact in the petition for reconsideration and in the original application."

The Board made no such statement here, nor could it have. It plainly rejected facts in the petition, accepted facts alleged but not proved by the opposition, and made such unproved facts the basis of decision. A further distinction between this case and *Cook Cleland* is that there the applicant had been given a chance to argue its case orally to the CAB and failed to do so.

We believe that a sound statement of current law on the right to a hearing at the administrative level in the absence of statutory provision therefor is found in the court's opinion in *First Nat. Bank of Smithfield, N. C.* v. *First Nat. Bank of E. N. C.,* 232 F. Supp. 725 (E.D.N.C., 1964). The case involved the obligation of the Comptroller of the Currency to afford a hearing on applications for branch-banking permits. The Court held that such obligation existed:

> "If the use of the word 'approval' is deemed to commit agency action to agency discretion within the meaning of the second exception to § 10, nevertheless it must be a sound discretion exercised in a manner that is not violative of procedural due process." (232 F. Supp. at 729-30)
>
> * * *
>
> "Granting the Comptroller of the Currency a specialized knowledge in the field of banks and banking

and that his decisions should stand if supported by substantial evidence and do not exceed his statutory authority, nevertheless, where, as here, there was no hearing, no record of the proceedings and no findings of fact, but only a bare decision, it cannot be determined whether his acts were arbitrary or illegal." (232 F. Supp. at 730)

* * *

"Any provision of the National Banking Act that would deny procedural due process would raise a serious constitutional question. Considering the legislative history of the Administrative Procedure Act and the intent of Congress in its enactment, the Act is sufficiently elastic to provide procedural due process in the administration of the National Banking Act." (232 F. Supp. at 731)

Procedural due process—or any process—was denied by the CAB in this case, and its order of denial must be set aside.

CONCLUSION

We request that this Court set aside the order under review and direct the CAB to issue an order exempting Island; or alternatively, that the case be remanded for processing under prescribed guidelines and constitutional procedures.

Respectfully submitted,

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Amy Scupi
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Attorneys for Petitioner

February 23, 1966

APPENDIX A

Federal Aviation Act of 1958

Section 101, 49 U.S.C. 1301:

(10) "Air transportation" means interstate, overseas, or foreign air transportation or the transportation of mail by aircraft.

* * *

(18) "Federal airway" means a portion of the navigable airspace of the United States designated by the Administrator as a Federal airway.

* * *

(21) "Interstate air transportation", "overseas air transportation", and "foreign air transportation", respectively, mean the carriage by aircraft of persons or property as a common carrier for compensation or hire or the carriage of mail by aircraft, in commerce between, respectively—

(a) a place in any State of the United States, or the District of Columbia, and a place in any other State of the United States, or the District of Columbia; or between places in the same State of the United States through the airspace over any place outside thereof; or between places in the same Territory or possession of the United States, or the District of Columbia;

(b) a place in any State of the United States, or the District of Columbia, and any place in a Territory or possession of the United States; or between a place in a Territory or possession of the United States, and a place in any other Territory or possession of the United States; and

(c) a place in the United States and any place outside thereof; whether such commerce moves wholly by aircraft or partly by aircraft and partly by other forms of transportation.

Section 102, 49 U.S.C. 1302:

In the exercise and performance of its powers and duties under this Act, the Board shall consider the following, among other things, as being in the public interest, and in accordance with the public convenience and necessity:

(a) The encouragement and development of an air-transportation system properly adapted to the present and future needs of the foreign and domestic commerce of the United States, of the Postal Service, and of the national defense;

(b) The regulation of air transportation in such manner as to recognize and preserve the inherent advantages of, assure the highest degree of safety in, and foster sound economic conditions in, such transportation, and to improve the relations between, and coordinate transportation by, air carriers;

(c) The promotion of adequate, economical, and efficient service by air carriers at reasonable charges, without unjust discriminations, undue preferences or advantages, or unfair or destructive competitive practices;

(d) Competition to the extent necessary to assure the sound development of an air-transportation system properly adapted to the needs of the foreign and domestic commerce of the United States, of the Postal Service, and of the national defense;

(e) The promotion of safety in air commerce; and

(f) The promotion, encouragement, and development of civil aeronautics.

Section 204, 49 U.S.C. 1324:

* * *

(b) The Board is empowered to confer with or to hold joint hearings with any State aeronautical agency, or other State agency, in connection with any matter arising under this Act within its jurisdiction, and to avail itself of the cooperation, services, records, and facilities of such State agencies as fully as may be practicable in the administration and enforcement of this Act.

Section 312, 49 U.S.C. 1353:

(a) The Administrator is directed to make long range plans for and formulate policy with respect to the orderly development and use of the navigable airspace, and the orderly development and location of landing areas, Federal airways, radar installations and all other aids and facilities for air navigation, as will best meet the needs of, and serve the interest of civil aeronautics and national defense, except for those needs of military agencies which are peculiar to air warfare and primarily of military concern.

Section 401, 49 U.S.C. 1371:

(a) No air carrier shall engage in any air transportation unless there is in force a certificate issued by the Board authorizing such air carrier to engage in such transportation.

* * *

(d) (1) The Board shall issue a certificate authorizing the whole or any part of the transportation covered by the application, if it finds that the applicant is fit, willing, and able to perform such transportation properly, and to conform to the provisions of this Act and the rules, regulations, and requirements of the Board hereunder, and that such transportation is required by the public convenience and necessity; otherwise such application shall be denied.

Section 406, 49 U.S.C. 1376:

* * *

(b) In fixing and determining fair and reasonable rates of compensation under this section, the Board, considering the conditions peculiar to transportation by aircraft and to the particular air carrier or class of air carriers, may fix different rates for different air carriers or classes of air carriers, and different classes of service. In determining the rate in each case, the Board shall take into consideration, among other factors, (1) the condition that such air carriers may hold and operate under certificates authorizing the carriage of mail only by providing necessary and adequate facilities and service for the transportation

of mail; (2) such standards respecting the character and quality of service to be rendered by air carriers as may be prescribed by or pursuant to law; and (3) the need of each such air carrier (other than a supplemental air carrier) for compensation for the transportation of mail sufficient to insure the performance of such service, and, together with all other revenue of the air carrier, to enable such air carrier under honest, economical, and efficient management, to maintain and continue the development of air transportation to the extent and of the character and quality required for the commerce of the United States, the Postal Service, and the national defense.

Section 416, 49 U.S.C. 1386:

(a) The Board may from time to time establish such just and reasonable classifications or groups of air carriers for the purposes of this title as the nature of the services performed by such air carriers shall require; and such just and reasonable rules and regulations, pursuant to and consistent with the provisions of this title, to be observed by each such class or group, as the Board finds necessary in the public interest.

(b) (1) The Board, from time to time and to the extent necessary, may (except as provided in paragraph (2) of this subsection) exempt from the requirements of this title or any provision thereof, or any rule, regulation, term, condition, or limitation prescribed thereunder, any air carrier or class of air carriers, if it finds that the enforcement of this title or such provision, or such rule, regulation, term, condition, or limitation is or would be an undue burden on such air carrier or class of air carriers by reason of the limited extent of, or unusual circumstances affecting, the operations of such air carrier or class of air carriers and is not in the public interest.

(2) The Board shall not exempt any air carrier from any provision of subsection (k) of section 401 of this title, except that (A) any air carrier not engaged in scheduled air transportation, and (B), to the extent that the operations of such air carrier are conducted

during daylight hours, any air carrier engaged in scheduled air transportation, may be exempted from the provisions of paragraphs (1) and (2) of such subsection if the Board finds, after notice and hearing, that, by reason of the limited extent of, or unusual circumstances affecting, the operations of any such air carrier, the enforcement of such paragraphs is or would be such an undue burden on such air carrier as to obstruct its development and prevent it from beginning or continuing operations, and that the exemption of such air carrier from such paragraphs would not adversely affect the public interest: *Provided,* That nothing in this subsection shall be deemed to authorize the Board to exempt any air carrier from any requirement of this title, or any provision thereof, or any rule, regulation, term, condition, or limitation prescribed thereunder which provides for maximum flying hours for pilots or co-pilots.

APPENDIX B

CONTENTS

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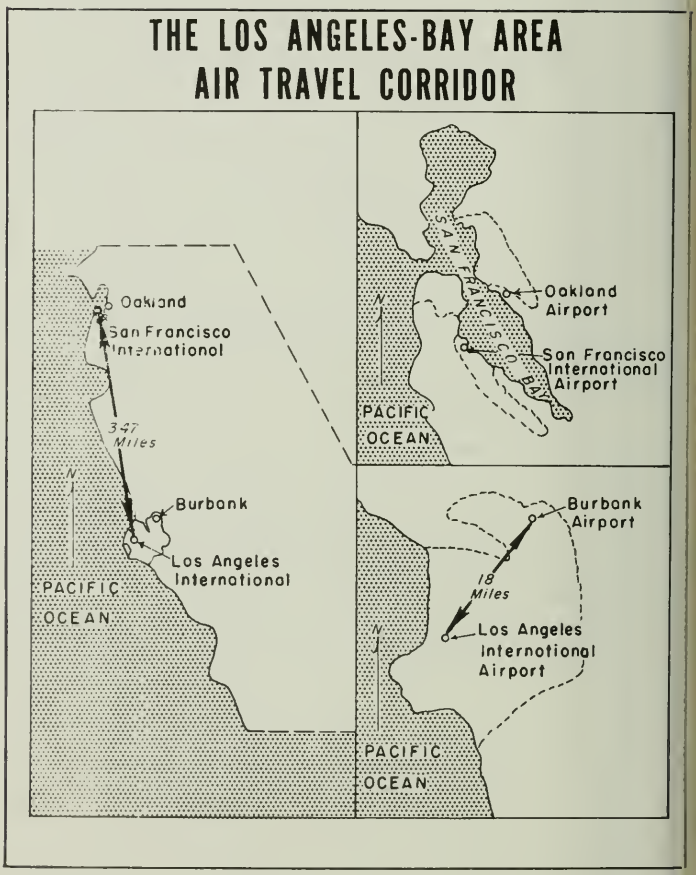
THE LOS ANGELES-BAY AREA
AIR TRAVEL CORRIDOR
Oakland
San Francisco International
347 Miles
Burbank
Los Angeles International
PACIFIC OCEAN
N
SAN FRANCISCO BAY
Oakland Airport
San Francisco International Airport
PACIFIC OCEAN
N
Burbank Airport
18 Miles
Los Angeles International Airport
PACIFIC OCEAN
N

INTRODUCTION

This study of air travel between Los Angeles and San Francisco aims, by interpreting changes in traffic, fares, and other things, to throw light on the factors generating air passenger traffic. The particular focus is the effect of fare changes, since these are subject to some influence by the Civil Aeronautics Board.

The method of study is simple. From the chronology of events in the market, the most significant are selected, their relationships studied, and conclusions drawn according to the best judgment of the investigator. The difficulties are well known, and need only be mentioned here. Historical change is compound of many factors; to isolate and measure them singly is a challenging task.

This is the first of several studies of particular air travel markets, selected because they have been commanding attention by changing fares and burgeoning growth of passenger traffic.

This report was prepared by Messrs S Brown, W. Watkins, and K. Paxson and Miss J. Ronson of the Research and Statistics Division of the Bureau of Accounts and Statistics of the Civil Aeronautics Board. The contents of the report are the responsibility of this staff and do not necessarily reflect official views or opinions of the Board Members themselves.

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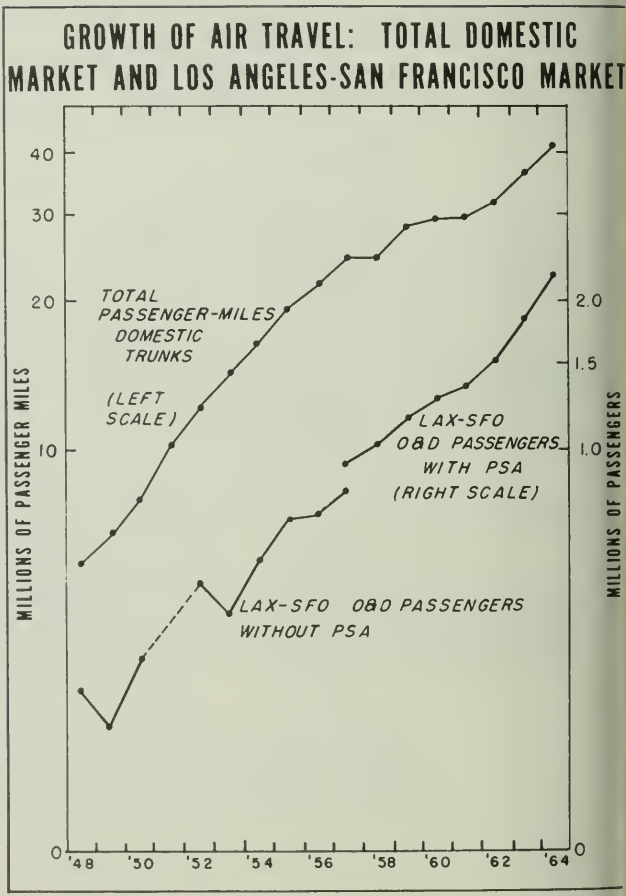


DATA: TABLE 1

THE LOS ANGELES-SAN FRANCISCO
AIR TRAVEL CORRIDOR

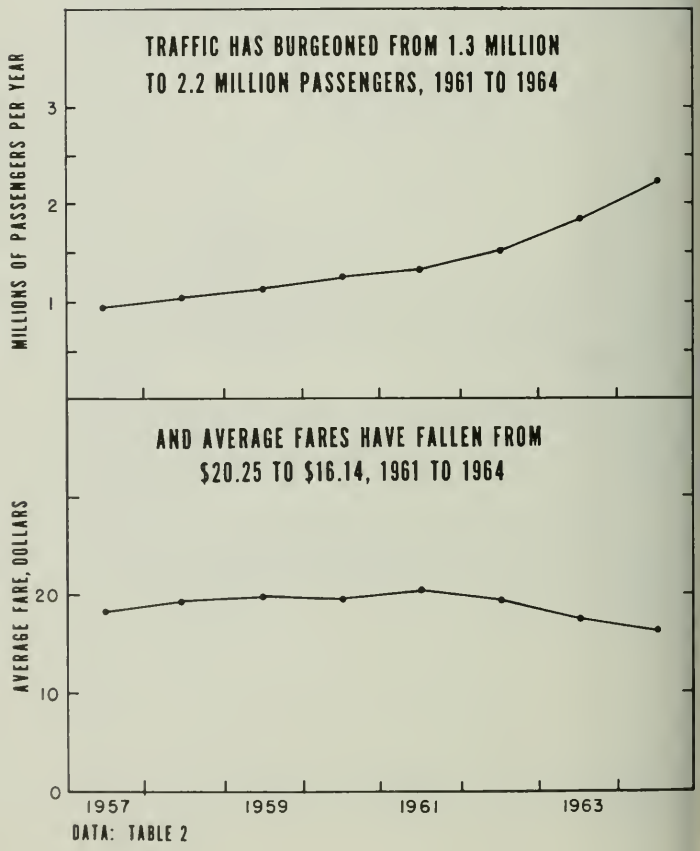
The Market

Los Angeles-San Francisco is the heaviest traveled of all city-pair markets in the world. Air travel on the 347 mile route has grown at a remarkable rate in recent years. From 1957 to 1964 air passengers increased from 940 thousand to 2.2 million, almost 2 1/2-fold. Over the same period for comparison, traffic on the domestic trunk airlines increased 70%, from 24.5 million to 41.7 million passenger-miles.

Part of this vigorous growth is attributable to rapid economic expansion of the West Coast communities. California's population, for example, increased by 27%, 1957 to 1964, compared to a national rate of growth of 12%. Incomes too, are nearly one-fourth higher than the national average and tend to grow at least at comparable rates.

The retardation of growth of air travel from 1957 to 1961, so visible in the national figures, was much less noticeable in the Los Angeles-San Francisco market. Growth since 1961 has accelerated to the phenomenal rate of nearly 19% per year. At 2.2 million in 1964, the number of passengers is expected to be close to 2.7 million in 1965.

ON THE BUSY LOS ANGELES-SAN FRANCISCO ROUTES:



DATA: TABLE 2

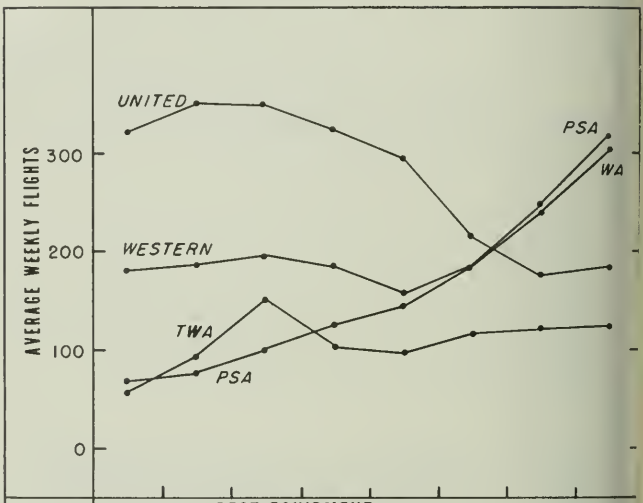
The Growth of Traffic and the Carriers

The chart opposite shows the striking surge, since 1961, of traffic in the Los Angeles-San Francisco air travel market.

At the same time, average fares have dropped more than one-fifth: from more than $20 for the 347 mile trip, to about $16 in 1964. From all indications, average fares are declining further this year with continued sharp competition among the carriers. The great surge of traffic accompanying these fare declines suggests that the level of fares may be close to a critical point at which a good deal of diversion from other modes of travel - automobile and bus for example - is taking place. Advertising of the airlines along the Los Angeles to San Francisco highways stresses the low fares, the one-hour flying time, and the greater convenience of air over motor travel.

There are four major air carriers in this market. United Airlines was dominant for years. Western was a close second. Trans-World serves the market only as a segment of longer routes. A small intra-state carrier, Pacific Southwest Airlines, started service in 1949 with a single, rented DC-3. Always a very low-fare carrier, and operating up and down the coast between San Diego, Los Angeles, and San Francisco, PSA was once called "The Poor Sailor's Airline".

FLIGHTS, EQUIPMENT, AND ELAPSED TIME



	BEST EQUIPMENT							
PSA	DC-4	DC-4	DC-4	ELECTRA	ELECTRA	ELECTRA	ELECTRA	ELECTRA
TWA	L-1049	L-1049	L-1049	B-707	B-707	B-707	B-707	B-707
UA	DC-6	DC-6	DC-6	DC-6	B-720	B-720	DC-8	B-727
WA	DC-6B	DC-6B	DC-6B	DC-6B	ELECTRA	ELECTRA	DC-6B	DC-6B
	BEST FLIGHT TIME							
PSA	1:40	1:40	1:40	0:55	1:00	1:00	1:00	1:00
TWA	1:47	1:47	1:51	1:10	1:10	1:07	1:07	1:05
UA	1:41	1:41	1:42	1:42	1:10	1:10	1:05	0:55
WA	1:36	1:36	1:36	1:36	1:07	1:09	1:36	1:36
	1957		1959		1961		1963	

DATA: APPENDIX B

TRAFFIC, FARES, AND COMPETITION

Flights, Equipment, and Elapsed Time

For the four carriers in the Los Angeles-San Francisco market the chart opposite portrays the trends of their flights, types of aircraft, and scheduled flying times

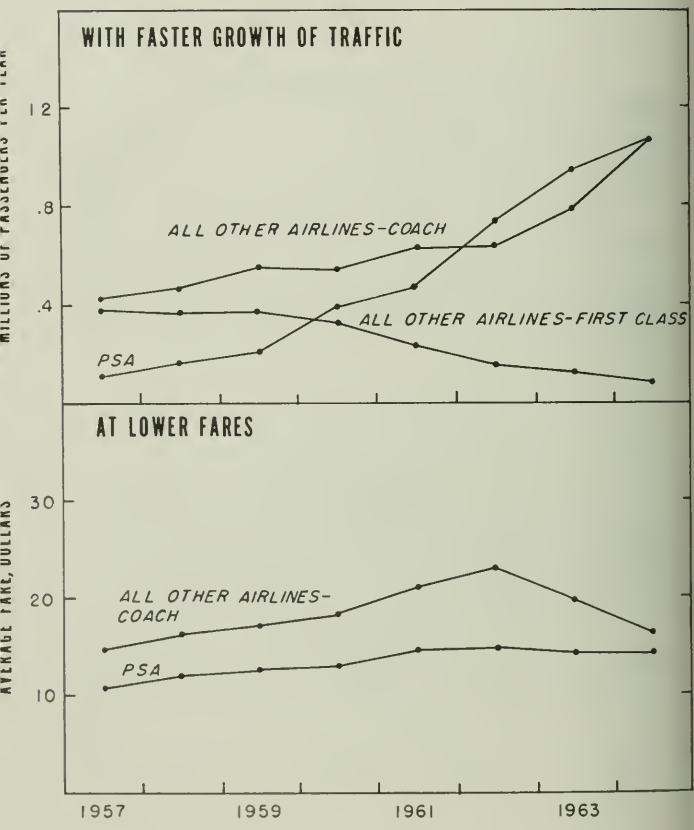
Adding flights in a market may generate traffic for a carrier up to a certain threshold, after that point changes in flights are the effect, not the cause, of changes in traffic. Accordingly, the long run trends of flights offered provide a rough measure of competitive traffic shares - rough because of differences in seats and configuration among the different aircraft types However, the dramatic change in the relative market positions of the four carriers, 1957-1964 stands out clearly

In these annual figures, PSA's rise has been uninterrupted, and picked up rapidly after 1961. United declined until 1964. Western became a strong contender starting in 1962 with its low-fare, "Thriftair" service in older DC-6B planes Trans-World has maintained a fairly steady position

Except for Western's "Thriftair" experiment, the carriers have since 1960 been fairly competitive with respect to quality of equipment and flying times PSA was first with Electras in 1960, securing a brief advantage over United and Western in this respect United first introduced the highly efficient and attractive B-727 in the fall of 1964, stealing a march on all competitors

The changeover from piston to turbine airplane, practically completed by 1961, reduced flying time by about three-quarters of an hour - from an hour and forty minutes to one hour or less.

PACIFIC SOUTHWEST AIRLINES HAS REACHED THE TOP OF THE LAX-SFO MARKET



DATA: TABLE 3

Fares and Competitive Shares

From the beginning, and till recently, Pacific Southwest Airlines maintained fares for its dense-configuration (98-seat Electras, for example) single-class service substantially below the coach fares of its trunk-airline competitors. In 1957 PSA's fare was $10 99; trunk coach fares were $14 85 (all fares include tax). In 1961, PSA's Electra fare was $14 85; trunk airlines jet coach fares were $20 30 till August, and then were raised to $25.25 At present, PSA has the lowest fare on the route, $12.00 for a one-hour flight in Electras. For a B-727 flight, PSA now charges $14.18, the same as the trunk airlines' jet-commuter service (For detailed information on fares by class of service and kind of equipment see Table 9, Appendix A) The chart opposite shows the great differences in both level and trend, 1957 to 1964, between PSA's fares and average coach fares of its trunk airline competitors

With lower fares, PSA forged ahead in volume of traffic. But starting in 1962, the trunk airlines' determined competition in both quality of service and fares has brought them, together, equal with PSA in number of coach passengers And these competitive efforts have, undoubtedly, expended total traffic far above what it might otherwise be.

PSA's success with dense configuration seating, 98 seats in Electras, 122 seats in their 727, supports the point of view that seat space is not an important factor affecting traffic - at least on short to medium stage-lengths

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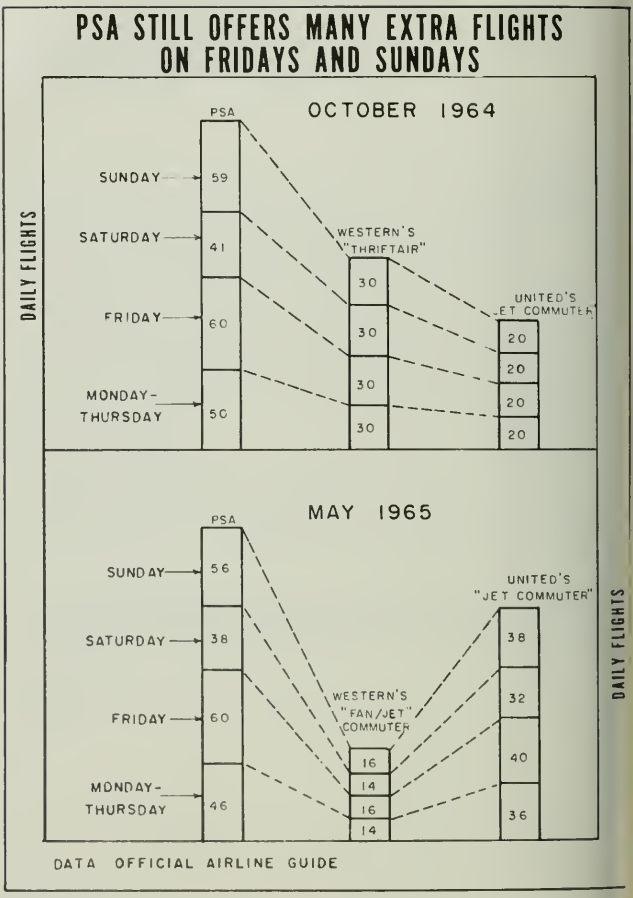
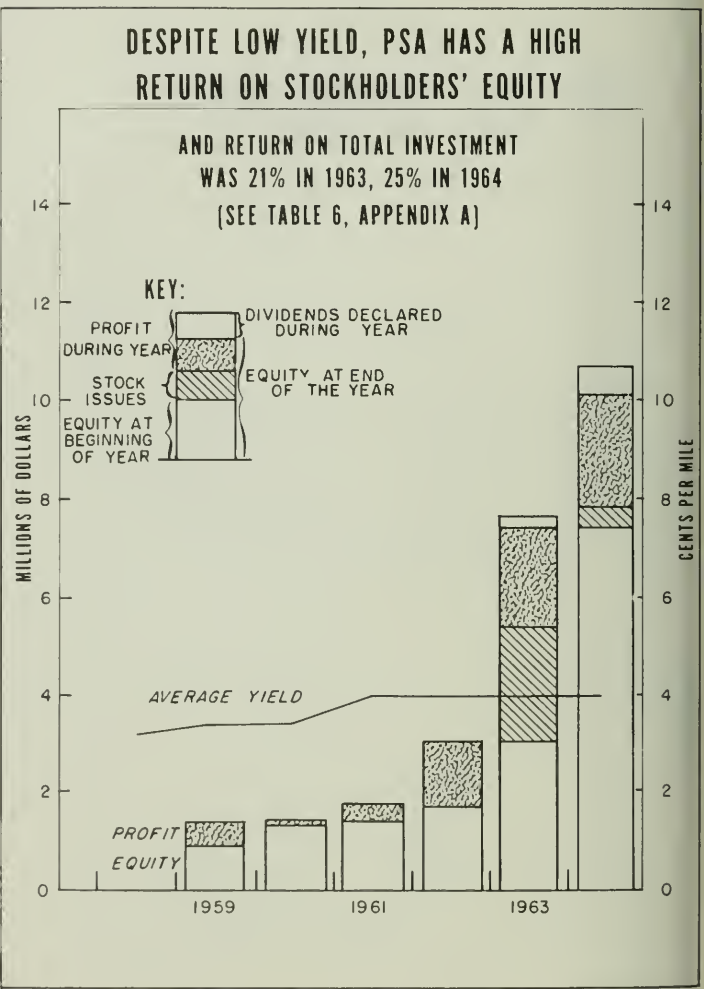

PSA STILL OFFERS MANY EXTRA FLIGHTS ON FRIDAYS AND SUNDAYS
OCTOBER 1964
PSA
WESTERN'S "THRIFTAIR"
UNITED'S JET COMMUTER
DAILY FLIGHTS
SUNDAY
SATURDAY
FRIDAY
MONDAY-THURSDAY
59
41
60
50
30
30
30
30
20
20
20
20
MAY 1965
PSA
UNITED'S "JET COMMUTER"
WESTERN'S "FAN/JET" COMMUTER
DAILY FLIGHTS
SUNDAY
SATURDAY
FRIDAY
MONDAY-THURSDAY
56
38
60
46
16
14
16
14
38
32
40
36
DATA OFFICIAL AIRLINE GUIDE

Frequencies and Week-end Flights

Pacific Southwest Airlines has always tried especially to attract heavy week-end traffic - to a far greater extent than the three competitive trunk airlines. PSA has many extra flights on Fridays and Sundays.

Friday and Sunday travel is probably for personal rather than for business reasons. PSA has thus appealed, successfully, to the large potential market - people who formerly traveled by other modes or did not travel at all.


DESPITE LOW YIELD, PSA HAS A HIGH RETURN ON STOCKHOLDERS' EQUITY
AND RETURN ON TOTAL INVESTMENT WAS 21% IN 1963, 25% IN 1964 (SEE TABLE 6, APPENDIX A)
KEY:
PROFIT DURING YEAR
DIVIDENDS DECLARED DURING YEAR
STOCK ISSUES
EQUITY AT END OF THE YEAR
EQUITY AT BEGINNING OF YEAR
MILLIONS OF DOLLARS
CENTS PER MILE
AVERAGE YIELD
PROFIT
EQUITY
0
2
4
6
8
10
12
14
1959
1961
1963

Pacific Southwest Airlines Makes Money

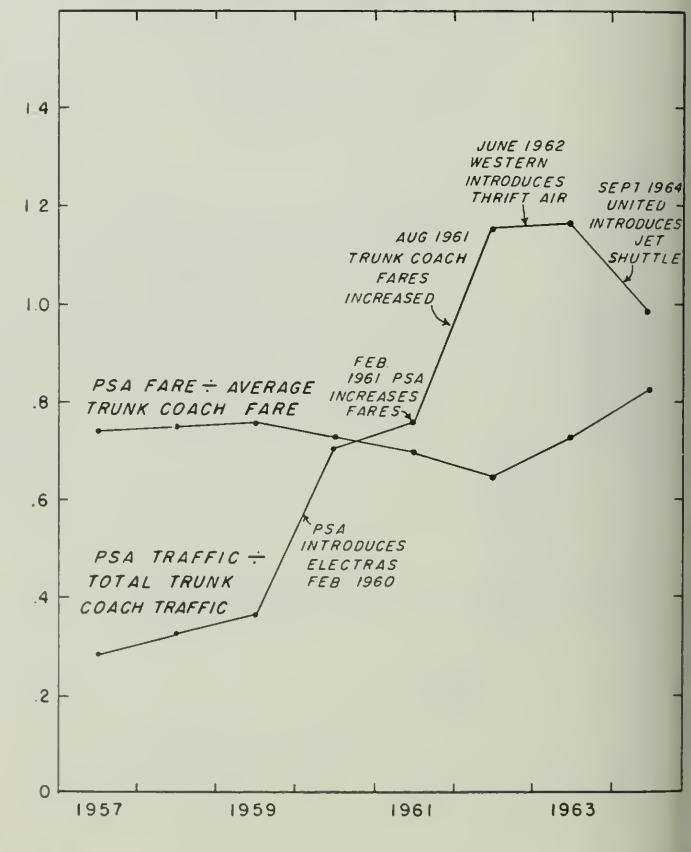
PSA's yield, per passenger-mile, is under 4 cents. Yet the firm has a good rate of return and has rapidly increased stockholder equity by plowing back substantial earnings

The bar chart opposite shows, for each year from 1959 through 1964, the equity at the beginning of the year (lower white portion) and the earnings during the year Because nearly all earnings have been plowed back, the equity has grown by approximately the amount of the profit plus proceeds of new stock issues Thus at the beginning of 1959, stockholder equity was slightly less than $1 million; at the end of 1964 it was 10.1 million. Low earnings in 1960 and 1961 were due to speed restrictions and structural modifications of the company's Electras, and to losses incurred as a result of establishing service to Oakland airport (soon discontinued) with a DC-6B aircraft.

The company began to pay dividends in 1963 and increased them in 1964. Total dividends were $204,290 in 1963, $567,245 in 1964.

In 1964, PSA's return on stockholder equity was nearly 34%; return on total investment was 25%. (Further details are in Table 6, Appendix A.)

COMPETITION TAKES MANY FORMS



DATA: TABLE 4

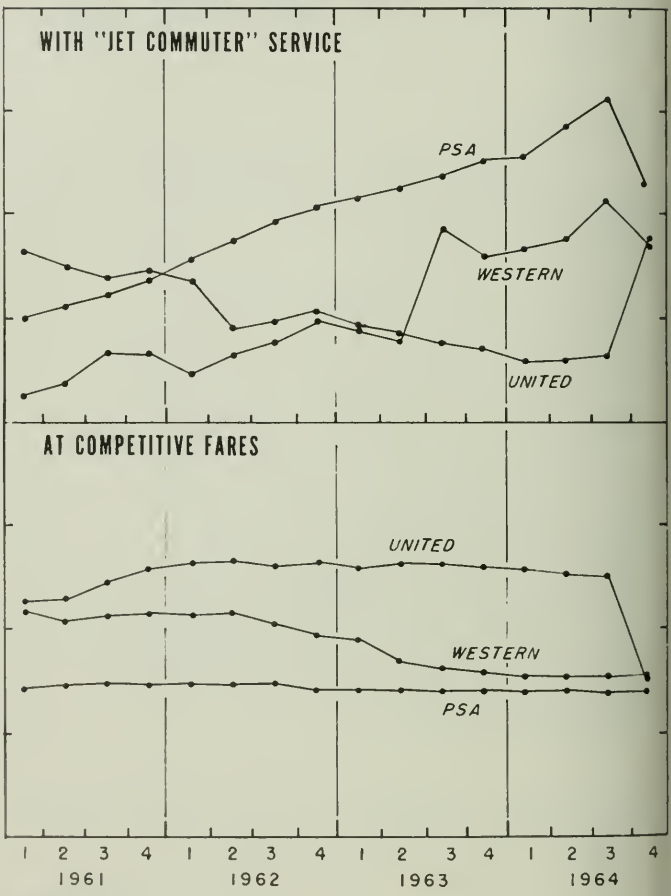
Multiform Competition

Pacific Southwest Airlines has determinedly undercut fares of competitive air carriers. But keeping its equipment competitive, and the fare increases and decreases of the three trunk carriers, have also been highly important to PSA's progress in the market.

This chart shows, first, the ratio of PSA's traffic, year by year, to the three trunk airlines' coach traffic. The rising portion of the curve means that PSA was increasing its market share until 1964 The chart also shows the ratio of PSA's fare to the average coach fare of the trunk airlines. This ratio has always been below one, indicating PSA's consistently low fares. The ratio fell until 1962-63, when lower fares by PSA's competitors caused it to rise. Notice that PSA's traffic ratio rises as its fare ratio falls, and that the traffic ratio turns and falls as the fare ratio begins to rise in 1963-64.

But the chart also shows the timing and the apparent effect of other competitive moves, especially the introduction of superior equipment Flying DC-3's and DC-4's at low fares, PSA made slow gains. The change over to Electras in early 1960, with a flying time of one hour at the same low fares, brought a dramatic increase of traffic. In the middle of 1961 the trunk air carriers raised jet coach fares from $20.30 to $25.25 (with tax), $10.40 above PSA's $14.85 fare for Electra service; PSA's traffic surged. Western Airlines' introduction of "Thriftair" service in slower DC-6B's at fares below PSA's, held up the progress of the intra-state airline. United Airlines' introduction, in late 1964, of "jet commuter" service in new B-727 jets at fares nearly as low as PSA's made a great change in competitive positions.

UNITED AIRLINES RECOVERS SHARPLY AT WESTERN'S AND PSA'S EXPENSE



DATA: TABLE 5

United Airlines' "Jet Commuter" Service

Long declining in the market, United Airlines made a powerful bid in September 1964 to regain its dominant competitive position. United offered "jet commuter" service in the new, three-jet B-727's at a fare of $15.23, only a dollar above PSA's fare for Electra service. In April 1965 United reduced the fare to $14.18, matching PSA's fare.

The effect was dramatic. United's traffic increased sharply at Western's and PSA's expense. This year, PSA has begun service with its own single B-727, flying 111 flights per week with the three-jet aircraft at load factors reportedly as high as 80 percent. Four more 727's are to be delivered to PSA this year, and another in early 1966. Meanwhile PSA has 291 additional weekly flights in Electras at fares of $12.00 including tax - a total of 402 flights per week, a hundred more than any other carrier. Western dropped "Thriftair" and made a strong bid with jet service in B-720B's at competitive fares of $14.18.

Accordingly, continued sharp competition in the market may be expected in 1965 to bring down fare levels still more, to expand traffic, and to improve equipment and service.

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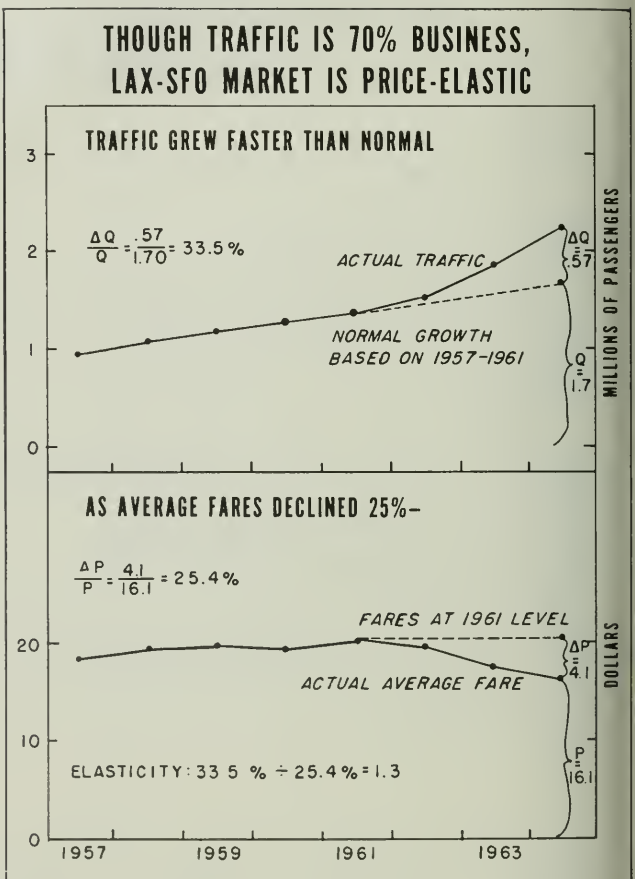


DATA: TABLE 2, 7

The Fare-Elasticity of Demand

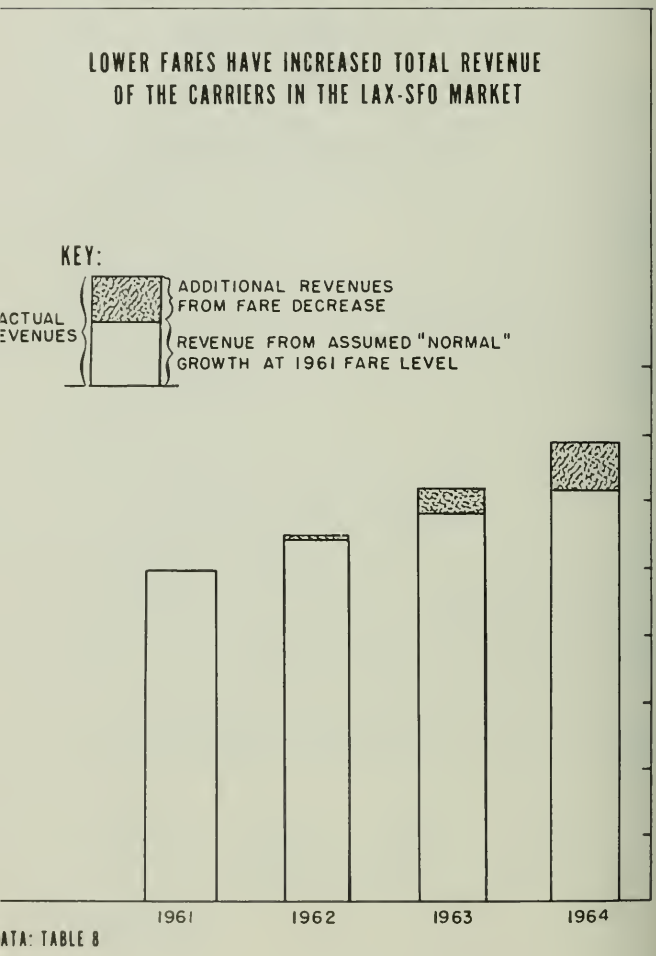
Studies by the airlines indicate that most of the travel on the Los Angeles-San Francisco route is for business purposes. The proportion is about 70 percent, somewhat above the national average. However, traffic appears to be elastic with respect to fares; declines of average fares bring more-than-proportional increases of traffic.

Pacific Southwest Airlines' always - low fares have attracted traffic from competitors, have induced fare reductions by them, have brought down average fares and have apparently expanded total traffic far above with it might otherwise be. This process implies that PSA has operated at relatively high load factors. Authentic information is not available, but high load factors would be consistent with PSA's brilliant earnings performance. Load factor of the Company's single 727 was reported above 80% in May 1965. Estimates based on revenue plane miles flown, seats per plane, and passenger-miles indicate system load factors for PSA of 71% in 1961, and 77% in 1962 and 1963. An estimate for the year 1964 based on flights, seats per flight, and passengers indicated a load factor of nearly 80%.

Estimating fare-elasticity of demand in a single market is especially difficult. However, if we take the smooth rise of traffic from 1957 to 1961 during which period fares did not change very much, as "normal" and as comprising all the other important factors influencing demand growth of population and income, reduction of flying time, etc., we may impute the extra increase of traffic since 1961 to the fall of average fares and compute a fare-elasticity of 1.3. The detail of the computation is shown on the chart opposite and in Table 7, Appendix A.

This estimate may be low. The full effects on traffic of the decline of fares have not yet been felt. Many new air travelers have been initiated by the attractive low fares, and having flown once or twice they are far more likely to fly again. Accordingly, the fare-elasticity is probably a good deal greater for the longer run.

REVENUES IN THE LAX-SFO MARKET



Revenues in the Los Angeles - San Francisco Market

Revenues in the Los Angeles-San Francisco market increased from $24 million in 1961 to $34 million in 1964 The chart opposite however, shows that if the 1961 average fare level of $18 41 (without-tax) had been maintained, normal growth would have produced $30 million in revenues by 1964. Thus, the traffic stimulated by reductions resulted in additional revenues of $208 thousand in 1962, $2.1 million in 1963, and $3 8 million in 1964 Since the market is price-elastic, further declines in fares would produce additional gross revenues for the carriers

This is not to say however, that fare reductions would necessarily improve profits Since unit costs would probably not decrease in proportion to the decline of yields, higher load factors would be necessary for the carriers to break even But because of the intense competition in this market, higher load factors may be increasingly difficult to attain.